

Letters of Findings: 08-0009 and 08-0010
Sales and Use Tax
For the Years 2001, 2002, 2003, 2004, 2005

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ISSUES

I. Sales and Use Tax – Imposition.

Authority: IC § 6-8.1-5-1; IC § 6-2.5-3-2; IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-4-1; IC § 6-2.5-8-8; [45 IAC 2.2-3-9](#); [45 IAC 2.2-3-12](#); Lafayette Square Amoco, Inc. v. Indiana Dep't of Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Gross Income Tax Division v. National Bank and Trust Co., 79 N.E.2d 651 (Ind. 1948).

Taxpayer protests the imposition of use tax on some items.

II. Tax Administration – Negligence Penalty.

Authority: IC § 6-8.1-10-2.1; [45 IAC 15-11-2](#).

STATEMENT OF FACTS

Taxpayer does construction and excavation work. Taxpayer was registered as an Indiana retail merchant, however Taxpayer did not file sales and use tax returns. The Indiana Department of Revenue ("Department") conducted a sales and use tax audit of Taxpayer for calendar years 2001, 2002, 2003, 2004, and 2005. The audit was summarized in two reports: one report for all the years through May 23, 2005, with the 2005 short year due to a bankruptcy filing on that date, and a second report for the 2005 post-bankruptcy period. Both audits assessed additional sales and use tax. Taxpayer protested some items in the assessments, and a hearing was held on the protests. This Letter of Findings combines the two protests. Additional facts will be provided as necessary.

I. Sales and Use Tax – Imposition.

DISCUSSION

The audit found that for the most part, as a lump sum contractor, Taxpayer paid sales tax on its purchases of construction materials. However, the audit revealed that sometimes vendors failed to charge sales tax at the time of sales of the construction materials to Taxpayer. Because Taxpayer did not have a use tax accrual system in place, Taxpayer did not accrue use tax on these materials. The materials were converted to realty on land Taxpayer did not own. The audit assessed use tax on these purchases of construction materials.

The Department notes that all tax assessments are presumed to be accurate and the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(b), (c); Lafayette Square Amoco, Inc. v. Indiana Dep't of Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

In accordance with IC § 6-2.5-2-1, a sales tax, known as state gross retail tax, is imposed on Indiana retail transactions unless a valid exemption is applicable. IC § 6-2.5-4-1 provides that a retail transaction involves the transfer of tangible personal property. Indiana imposes a use tax on tangible personal property stored, used, or consumed in Indiana when no sales tax was paid at the time of purchase. IC § 6-2.5-3-2. There are number of statutory exemptions from the use tax. All exemptions must be strictly construed against the party claiming the exemption. Gross Income Tax Division v. National Bank and Trust Co., 79 N.E.2d 651, 654 (Ind. 1948).

[45 IAC 2.2-3-12](#) states use tax obligations of contractors generally:

(a) Tangible personal property purchased to become a part of an improvement to real estate under a contract with an organization entitled to exemption is eligible for exemption when purchased by the contractor.

(b) In order to be exempt on such purchases, the contractor must be registered as a retail merchant, must obtain an exemption certificate from the exempt organization, and must issue an exemption certificate to his supplier.

(c) Utilities, machinery, tools, forms, supplies, equipment, or any other items used or consumed by the contractor and which do not become a part of the improvement to real estate are not exempt regardless of the exempt status of the person for whom the contract is performed.

(d) A person making a contract for the improvement to real estate whereby the material becoming a part of the improvement and the labor are quoted as one price is liable for the payment of sales tax on the purchaser [sic.] price of all material so used.

(e) A person selling tangible personal property to be used as an improvement to real estate may enter into a completely separate contract to furnish the labor to install or construct such improvement, in which case the sales tax shall be collected and remitted by such seller on the materials sold for this purpose. Such sale of materials must be identifiable as a separate transaction from the contract for labor. The fact that the seller subsequently furnished information regarding the charges for labor and material used under a flat bid quotation shall not be considered to constitute separate transactions for labor and material.

[45 IAC 2.2-3-9](#) states procedure when tax is not paid on construction materials when purchased by the contractor:

- (a) A contractor may purchase construction material exempt from the state gross retail tax only if he issues either an exemption certificate or a direct pay certificate to the seller at the time of purchase.
- (b) A contractor, who purchases construction material exempt from the state gross retail tax or otherwise acquires construction material "tax-free", is accountable to the Department of Revenue for the state gross retail tax when he disposes of such property.
- (c) A contractor has the burden of proof to establish exempt sale or use when construction material, which was acquired "taxfree", is not subject to either the state gross retail tax or use tax upon disposition.
- (d) Disposition subject to the state gross retail tax. A contractor-retail merchant has the responsibility to collect the state gross retail tax and to remit such tax to the Department of Revenue whenever he disposes of any construction material in the following manner:
 - (1) Time and material contract. He converts the construction material into realty on land he does not own and states separately the cost for the construction materials and the cost for the labor and other charges (only the gross proceeds from the sale of the construction material are subject to tax); or
 - (2) Construction material sold over-the-counter. Over the counter sales of construction materials will be treated as exempt from the state gross retail tax only if the contractor receives a valid exemption certificate issued by the person for whom the construction is being performed or by the customer who purchases over-the-counter, or a direct pay permit issued by the customer who purchases over-the-counter.
- (e) Disposition subject to the use tax. With respect to construction material a contractor acquired tax-free, the contractor is liable for the use tax and must remit such tax (measured on the purchase price) to the Department of Revenue when he disposes of such property in the following manner:
 - (1) He converts the construction material into realty on land he owns and then sells the improved real estate;
 - (2) He utilizes the construction material for his own benefit; or
 - (3) Lump sum contract. He converts the construction material into realty on land he does not own pursuant to a contract that includes all elements of cost in the total contract price.
- (f) A disposition under C. [subsection (e)(3) of this section] will be exempt from the use tax if the contractor received a valid exemption certificate, not a direct pay permit, from the ultimate purchaser or recipient of the construction material (as converted), provided such person could have initially purchased such property exempt from the state gross retail tax.

(Emphasis added).

Accordingly, based on the above, Taxpayer will either pay the supplier gross retail tax "up-front" when he initially purchases the construction materials or he will self-assess the gross retail tax in the form of use taxes when the materials are incorporated into the construction project. Either upfront or at the point where the materials are incorporated into realty, in lump sum contracts between the supplier and its contractors, it is Taxpayer, the contractor, who is ultimately responsible for paying the tax on the construction materials, unless Taxpayer can show that he either acquired or disposed of the property subject to exemption as evidenced by an exemption certificate.

IC § 6-2.5-8-8 states:

- (a) A person, authorized under subsection (b), who makes a purchase in a transaction which is exempt from the state gross retail and use taxes, may issue an exemption certificate to the seller instead of paying the tax. The person shall issue the certificate on forms and in the manner prescribed by the department. A seller accepting a proper exemption certificate under this section has no duty to collect or remit the state gross retail or use tax on that purchase.
- (b) The following are the only persons authorized to issue exemption certificates:
 - (1) retail merchants, wholesalers, and manufacturers, who are registered with the department under this chapter;
 - (2) organizations which are exempt from the state gross retail tax under [IC 6-2.5-5-21](#), [IC 6-2.5-5-25](#), or [IC 6-2.5-5-26](#) and which are registered with the department under this chapter; and
 - (3) other persons who are exempt from the state gross retail tax with respect to any part of their purchases.
- (c) The department may also allow a person to issue a blanket exemption certificate to cover exempt purchases over a stated period of time. The department may impose conditions on the use of the blanket exemption certificate and restrictions on the kind or category of purchases that are exempt.

First, Taxpayer protested reference items numbered 1224, 1247, 1271, 1302, 1470, 1503, 1449, and 1604 on page 11 of the first audit report. Taxpayer argued that these invoices contained amounts for materials that became part of realty that is owned by a public school. Thus the taxpayer contends that use tax should not be assessed for materials that became part of the school which is a tax exempt entity. Taxpayer similarly protested reference item numbered 701550 as material used in another school construction project and Contracts 000646 and 000726 for equipment rented for use in the same project – these items are listed on page 7 of the second audit report.

Taxpayer was asked to provide exemption certificates to support his contentions.

Taxpayer did not provide any certificates in support of the items protested in the first audit report. Taxpayer provided a copy of an exemption certificate pertaining to the second audit items referenced above, however the "name of purchaser" on the exemption certificate does not tie to Taxpayer, nor is the "description of items purchased" linked to the items Taxpayer is protesting. Also, the signature date on the exemption certificate is anywhere from a year to six months after the dates of the protested invoices.

These protested items therefore remain subject to use tax.

Second, Taxpayer also protested reference items numbered X05019-11, X04020-3, 701160, 701188, 701199, 869, 3386023 on page 21 of the first audit report, stating that he had paid tax at the time of purchase and that he had provided documentation during the audit. There is no record of this documentation. The Department's assessment is presumed to be accurate and Taxpayer bears the burden of proving that the assessment is incorrect. IC § 6-8.1-5-1(b), (c). Taxpayer did not provide copies of his documentation in support of his protest of these items.

These items, therefore, also remain subject to use tax.

Third, Taxpayer protests reference item 2260 on page 7 of the second audit report. Taxpayer argues that the item references a subcontractor he hired to tap a water main for him. Taxpayer argues that the subcontractor had his own materials and merely provided him with the service of drilling a hole in a water main. Taxpayer, however, did not provide any documentation – for example, an invoice or a receipt – to show that the charge relating to item 2260 was only for services.

This item also remains subject to use tax.

Taxpayer has not provided sufficient documentation to support his protest.

FINDING

Taxpayer's protest is respectfully denied.

II. Tax Administration – Negligence Penalty.

DISCUSSION

The Taxpayer also protested the imposition of the ten percent negligence penalty pursuant to IC § 6-8.1-10-2.1. Indiana Regulation [45 IAC 15-11-2](#)(b) clarifies the standard for the imposition of the negligence penalty as follows:

Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

The standard for waiving the negligence penalty is given at [45 IAC 15-11-2](#)(c) as follows:

The department shall waive the negligence penalty imposed under [IC 6-8.1-10-1](#) if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. Factors which may be considered in determining reasonable cause include, but are not limited to:

- (1) the nature of the tax involved;
- (2) judicial precedents set by Indiana courts;
- (3) judicial precedents established in jurisdictions outside Indiana;
- (4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc;
- (5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.

Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

Taxpayer has not affirmatively established, as required by [45 IAC 15-11-2](#)(c), that its failure to pay sales tax on its purchases was due to reasonable cause and not due to negligence.

FINDING

Taxpayer's protest is respectfully denied.

CONCLUSION

Taxpayer's protest of the use tax assessment is denied.

Taxpayer's protest of the negligence penalty is denied.